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C O N F I D E N T I A L BANDAR SERI BEGAWAN 000630

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SUBJECT: BRUNEI KEEPS THE OIL TAPS WIDE OPEN

REF: BANDAR SERI BEGAWAN 195

Classified By: Ambassador Emil Skodon, Reasons 1.4 (b) and (d)

¶1. (C) SUMMARY: Brunei's oil production and exports look set to reach their highest annual levels in 25 years in 2006, due to technical advances in offshore fields and a policy decision by the Government of Brunei (GOB) to maintain production at the maximum sustainable rate. The GOB has no pressing need for the resulting financial windfall, since it already had been earning more than it can spend and is running healthy current account and budget surpluses. It apparently decided on a high-production policy in order to help bring market prices down from the levels seen earlier in the year and buoy continued economic growth in oil consuming countries. The GOB probably also foresees lower oil prices in the future and so has wanted to take advantage of this year's high price levels while it could. END SUMMARY.

¶2. (SBU) Brunei's oil production and exports look set to reach their highest annual levels in 25 years in 2006. Preliminary data from the GOB Department of Statistics indicate that production averaged 219 thousand barrels per day (BPD) in the first half of 2007, and exports 207 thousand BPD. This represents a nine percent rise in production and seven percent rise in exports over 2005. Natural gas production and exports of liquefied natural gas (LNG) also increased in the first half, but at a lower rate. Gas production was up five percent to 1.2 billion cubic feet per day, and LNG exports 3.5 percent to 1.01 billion BTU's per day. These figures imply that in 2006 Brunei will be the EAP region's fifth largest exporter of oil and fourth largest exporter of gas.

¶3. (C) Technical factors provide part of the explanation for the increase in oil production. The country's main oil producer, Brunei Shell Petroleum (BSP), completed several long-term repair and upgrade projects in 2006, and its hi-tech Champion West Phase III offshore field, which employs "smart drilling" technologies such as downhole temperature sensors and fiber optic cables, began running at full production of 16.7 thousand BPD. However, the record production was ultimately driven by GOB policy decisions. Embassy learned that earlier this year the BSP Managing Director met with Energy Minister Pehin Yahya to brief him on the high rate of production and ask if the GOB wanted BSP to throttle back. Yahya reportedly told BSP to keep pumping oil at the maximum sustainable rate.

¶4. (C) The decision to keep the taps open, combined with high oil price levels in the second and third quarters of the year, will provide the GOB with a financial windfall. According to GOB statistics, the average export price for a barrel of Bruneian oil in the first half of 2006 was USDOLS 71.05, as compared to an annual average of USDOLS 57.72 in 2005. This implies oil export revenues of USDOLS 2.7 billion in just the first half of 2006 -- two thirds as much as Brunei earned from oil exports in the entire year of 2005.

Even with the decline in the market price of oil in the fourth quarter of 2006, overall revenues should remain strong. The long-term contracts under which Bruneian LNG is sold typically include pricing formulas that incorporate oil prices with a three month lag, meaning that the higher oil prices in the middle of 2006 will have led to higher prices for Bruneian LNG in the second half of the year.

15. (C) Comment: Brunei is a "low absorber" that does not need this extra revenue. According to the most recent IMF statistics, Brunei ran a current account surplus of 56 percent of GDP in 2005 and is set to go over 60 percent in 2006, and the GOB's primary budget surplus was over 20 percent of GDP in 2005, in part because expenditures reached only 90 percent of target levels due to an inability to execute infrastructure projects as rapidly as planned. The only apparent explanations why the GOB decided to make 2006 a record year for oil production are that it wanted to do its part to bring market prices down from the high levels seen earlier in the year in order to help support continued growth in consumer economies, and/or it foresaw lower prices in the future and so wanted to take advantage of this year's higher price levels while it could.

SKODON